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RESTRUCTURINGS

HAS THIS PROBLEM CHILD LEARNED ITS LESSON?

Kinder-Care restructures to cut debt and boost investor confidence

Building an empire of 1,235 red-steepled schoolhouses wasn't enough for Perry Mendel. In the past 2½ years, the founder and chairman of Kinder-Care Inc. has amassed an odd assortment of side businesses including two Florida thrifts, a specialty retail chain, and a deer-hunter's magazine called *Buckmasters*.

Mendel's disjointed buying spree hasn't done much for investors, who have watched their shares tumble 59% since 1987. In April, Kinder-Care's largest shareholder, SunBank, sold off its 6.9% stake in disgust. "It was a significantly unrewarding investment," says Anthony R. Gray, president of SunBank's investment group.

But now shareholders are being listened to—at least a bit. Amid persistent rumors of a takeover by Robert M. Bass of Texas, on May 29, the Montgomery (Ala.)-based Kinder-Care unveiled a complex $215 million restructuring plan that will spin off its remaining 87% stake in its child-care subsidiary, which trades separately as Kinder-Care Learning Centers Inc. "This will clean up both balance sheets and give both companies more flexibility to grow," says the 67-year-old Mendel, who is stepping down at Kinder-Care but will stay on as chairman of Learning Centers. Wall Street partly agrees: While shares of Kinder-Care hovered around 8, Learning Centers' stock jumped 33%, to 6¼ (chart).

LIGHTER LOAD. The restructuring wasn't all Mendel's idea. The catalyst behind his maneuver is Lodestar Group, a 1½-year-old New York investment firm headed by Kenneth H. Miller, former vice-chairman of Merrill Lynch Capital Markets Inc. After the firm recently built a 4.3% stake in Kinder-Care, management quickly acceded to Lodestar's restructuring plan: The investors will guarantee a $161 million rights offering for Kinder-Care stock owners, who will get half a share in Learning Centers for each share of Kinder-Care. Lodestar will also buy 3.5 million shares of Learning Centers at $5.50 apiece and will take two seats on its board.

Lodestar, which until now has only made minor investments in several smaller companies, should wind up with more than 5% of Kinder-Care and over 13% of Learning Centers. The firm's principals declined to comment on their plans but have said before that they aim to invest in companies for three or four years before selling out. Some on Wall Street believe Lodestar wants to rein in Kinder-Care's diversification and may even prod the company to sell off its laggard divisions. Others think it may take Learning Centers private.

Lodestar's cash infusion will come none too soon for Mendel's $935 million empire, which has been sinking under the crush of nearly $400 million in debt, mostly at floating rates. Learning Centers' first-quarter interest tab of $12 million halved its operating income to $11 million. Learning Centers recently capped its exposure through interest-rate swaps and is now negotiating to secure a sale-leaseback of its day-care properties. Combined with the rights offering, those measures should reduce its obligations from a huge 349% of equity to 130%, estimates Jeffrey D. Adams, an analyst at PaineWebber Inc.

STILL ENAMORED. The spinoff may bolster the day-care centers' prospects, but the restructuring could leave the remaining companies more vulnerable than ever to interest-rate swings: Profits from Kinder-Care's American Savings & Loan Assn.—which has been whipsawed by rising short-term rates—aren't covering the interest from its $150 million acquisition in 1988. As a result, Kinder-Care's first-quarter earnings plunged to $458,000, or 1¢ per share vs. 26¢ last year. It would have reported a loss if it hadn't booked 7¢ per share from its stake in Learning Centers. "What this stock still boils down to is an interest-rate play," says Napoleon H. Overton, an analyst at Morgan Keegan & Co.

Still, Kinder-Care's new chairman, Richard J. Grassgreen, remains enamored of the company's fortunes. "Our specialty retailing is poised for the same growth as day care," says Grassgreen, the former president. He may find it tough to restore confidence along a jaded Wall Street, but the restructuring could make investors give Kinder-Care a second look. Given its fall from grace, that may be the best it can hope for.

By Dean Foust in Atlanta

KINDER-CARE'S TWO STOCKS